



APPENDIX E-1

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Board of Directors
National Dairy Promotion and Research Board:

We have audited the accompanying balance sheets of National Dairy Promotion and Research Board (NDB) as of December 31, 2003 and 2002, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the NDB's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of National Dairy Promotion and Research Board at December 31, 2003 and 2002, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our 2003 audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the schedule of reconciliation of operations budget is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2003 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

March 26, 2004, except for note 7, as
to which the date is April 16, 2004



NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Balance Sheets

December 31, 2003 and 2002

Assets	2003	2002
Cash and cash equivalents (note 3)	\$ 5,691,663	8,686,682
Assessments receivable, net (note 4)	7,530,571	7,793,974
Accrued interest receivable	91	92
Fixed assets (net of accumulated depreciation of \$117,809 and \$108,888 in 2003 and 2002, respectively)	20,107	29,028
	<u>\$ 13,242,432</u>	<u>16,509,776</u>
 Liabilities and Net Assets		
Accounts payable:		
Related party – DMI	\$ 7,986,785	9,760,282
Other	138,784	199,157
Accrued expenses and other liabilities	192,891	273,365
Total liabilities	8,318,460	10,232,804
Commitments (note 5)		
Net assets – unrestricted	4,923,972	6,276,972
Total liabilities and net assets	<u>\$ 13,242,432</u>	<u>16,509,776</u>

See accompanying notes to financial statements.

NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Statements of Activities

Years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Revenue:		
Assessments	\$ 86,148,864	86,619,316
Interest income	42,161	71,972
Total revenue	<u>86,191,025</u>	<u>86,691,288</u>
Expenses:		
Program:		
Domestic marketing group	60,710,527	68,113,912
Research and evaluation group	4,952,087	3,491,799
Communications/member relations group	13,007,120	8,269,055
Export group	5,251,770	4,933,680
United States Department of Agriculture	554,121	454,482
Total program	<u>84,475,625</u>	<u>85,262,928</u>
General and administrative:		
DMI general and administrative	2,632,108	2,467,207
General and administrative	436,292	452,260
Total general and administrative	<u>3,068,400</u>	<u>2,919,467</u>
Total expenses	<u>87,544,025</u>	<u>88,182,395</u>
Decrease in net assets	(1,353,000)	(1,491,107)
Net assets at beginning of year	<u>6,276,972</u>	<u>7,768,079</u>
Net assets at end of year	<u>\$ 4,923,972</u>	<u>6,276,972</u>

See accompanying notes to financial statements.

NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Statements of Cash Flows

Years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Decrease in net assets	\$ (1,353,000)	(1,491,107)
Adjustments to reconcile decrease in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,921	8,609
Changes in assets and liabilities:		
Decrease in assessments receivable	263,403	863,523
Decrease in accrued interest receivable	1	4,917
Increase (decrease) in accounts payable	(1,833,870)	1,537,337
Decrease in accrued expenses and other liabilities	<u>(80,474)</u>	<u>(63,349)</u>
Net cash provided by (used in) operating activities	(2,995,019)	859,930
Cash flows used in investing activities:		
Acquisition of fixed assets	<u>—</u>	<u>(3,120)</u>
Net increase (decrease) in cash and cash equivalents	(2,995,019)	856,810
Cash and cash equivalents at beginning of year	<u>8,686,682</u>	<u>7,829,872</u>
Cash and cash equivalents at end of year	<u>\$ 5,691,663</u>	<u>8,686,682</u>

See accompanying notes to financial statements.

NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Notes to Financial Statements

December 31, 2003 and 2002

(1) Organization

The National Dairy Promotion and Research Board (NDB) was established on May 1, 1984, pursuant to The Dairy and Tobacco Adjustment Act of 1983 (Public Law 98-180), as part of a comprehensive strategy to reduce milk surplus supplies in the United States (U.S.) and increase human consumption of U.S.-produced fluid milk and other dairy products. The purpose of NDB is to establish a coordinated program of promotion and research designed to strengthen the U.S. dairy industry's position in the marketplace and to maintain and expand domestic and international markets' usage of U.S.-produced fluid milk and other dairy products.

The United States Department of Agriculture (USDA) approved a joint venture between NDB and the United Dairy Industry Association (UDIA) to form Dairy Management Inc. (DMI) effective January 1, 1995. The purpose of DMI, a related organization, is to promote greater coordination, efficiency, and effectiveness and avoid incompatibility and duplication in the marketing programs and projects undertaken by NDB and UDIA. NDB and UDIA will jointly plan, develop, and implement their various marketing programs and activities through DMI, subject to the approval of the USDA.

NDB funds DMI on a cost reimbursement basis. Core costs, which include staff salaries and benefits, travel, Board of Directors, and office overhead expenses are primarily funded by NDB, with UDIA funding one-half of Board of Directors and executive office costs. Marketing program costs, which include expenses associated with implementing the marketing programs of NDB and UDIA, are funded by NDB and UDIA based on the annual Unified Marketing Plan budget. NDB has funded DMI core costs of \$14,213,094 and \$13,862,831 and program costs of \$72,340,518 and \$73,412,822, for activity related to the years ended December 31, 2003 and 2002, respectively.

The U.S. Dairy Export Council (USDEC) is a related organization that was founded by the boards of both NDB and UDIA and began operations effective January 1, 1996. The purpose of USDEC is to improve the marketing conditions for the U.S. dairy industry with respect to the export of U.S. dairy products by promoting the acceptability, consumption, and purchase of U.S. dairy products in international markets. For the years ended December 31, 2003 and 2002, NDB reimbursed DMI \$5,251,770 and \$4,933,680, respectively, for USDEC's operations.

(2) Summary of Significant Accounting Policies

The financial statements of NDB have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. To facilitate the understanding of information included in the financial statements, summarized below are the more significant accounting policies.

(a) Cash Equivalents

NDB considers debt investment instruments with an original maturity of three months or less to be cash equivalents.

**NATIONAL DAIRY PROMOTION
AND RESEARCH BOARD**

Notes to Financial Statements

December 31, 2003 and 2002

(b) Assessments

Assessment revenue is generated by a mandatory assessment of 15 cents per hundredweight on all milk produced and marketed in the contiguous United States. Milk handlers and marketers can receive a credit of up to 10 cents per hundredweight for payments to USDA qualified state and regional generic dairy promotion organizations. For the years ended December 31, 2003 and 2002, the net NDB assessment was approximately 5.11 and 5.13 cents per hundredweight of milk marketed, respectively. Assessment revenue is recognized in the month in which milk is marketed.

(c) Fixed Assets

Fixed assets consist of computer equipment and software and are recorded at cost. Depreciation and amortization are provided in amounts sufficient to charge the cost of depreciable assets to operations over estimated service lives of five years using the straight-line method.

(d) Net Assets

All net assets of the NDB at December 31, 2003 and 2002 are unrestricted.

(e) Contract and Grant Expense

Expenses related to contracts are recognized as incurred. Grants for research projects typically require periodic reporting of project status and payments. Such payments are expensed as progress is achieved. In addition, a portion of the fund balance is designated for future payments under existing contracts and grants (see note 5).

(f) Income Taxes

NDB has received a determination letter from the Internal Revenue Service indicating that it is exempt from Federal and state income taxes on related income under 501(c)(3) of the Internal Revenue Code. There was no unrelated business taxable income for the years ended December 31, 2003 and 2002; therefore, no provision for income taxes has been reflected in the accompanying financial statements related to activities of NDB.

(g) Use of Estimates

Management of NDB has made certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

(h) Employee Costs

NDB's operations are staffed by DMI employees, who receive vacation, retirement, health, and other benefits provided by DMI.

**NATIONAL DAIRY PROMOTION
AND RESEARCH BOARD**

Notes to Financial Statements

December 31, 2003 and 2002

(3) Cash and Cash Equivalents

Cash and cash equivalents consist of the following as of December 31:

	<u>2003</u>	<u>2002</u>
Operating cash in banks and on hand	\$ 162,185	2,052,866
Federal agency discounted securities	<u>5,529,478</u>	<u>6,633,816</u>
	<u>\$ 5,691,663</u>	<u>8,686,682</u>

(4) Assessments Receivable

Assessments receivable are recorded at the estimated net amounts to be received based on the amount of milk marketed and the average payment per hundredweight. In accordance with Public Law 98-180, NDB forwards unpaid assessments to the USDA for collection and other legal proceedings. As of December 31, 2003 and 2002, approximately \$80,000 and \$367,000, respectively, of cumulative unpaid assessments were at USDA pending further action. Such amounts are not included in assessments receivable as of December 31, 2003 and 2002, and will not be recorded as revenue until such amounts are ultimately received. Civil penalties exist for any persons who do not pay the assessment and/or file required milk production assessment reports with NDB.

(5) Net Assets

During 2003 and 2002, NDB's Board designated a portion of net assets for use in continued funding of programs and for cash reserves. Total designations of net assets are as follows:

	<u>2003</u>	<u>2002</u>
Program designation for domestic marketing	\$ —	643,132
Cash reserves	<u>1,800,000</u>	<u>1,800,000</u>
Total designated net assets	1,800,000	2,443,132
Undesignated net assets	<u>3,123,972</u>	<u>3,833,840</u>
Total net assets – unrestricted	<u>\$ 4,923,972</u>	<u>6,276,972</u>

**NATIONAL DAIRY PROMOTION
AND RESEARCH BOARD**

Notes to Financial Statements

December 31, 2003 and 2002

The program designations as of December 31, 2003 and 2002 relate to contract commitments made during the following years:

	<u>2003</u>	<u>2002</u>
2003	\$ —	—
2002	—	643,132
Total contract commitments	<u>\$ —</u>	<u>643,132</u>

(6) Transactions with the United States Department of Agriculture

NDB reimburses the USDA for the cost of administrative oversight and compliance audit activities. These reimbursements amounted to \$554,121 and \$454,482 for the years ended December 31, 2003 and 2002, respectively.

(7) Litigation

NDB and the United States Department of Agriculture (USDA) are defendants in a lawsuit that claims the Dairy Promotion Program established by the Dairy Promotion Stabilization Act of 1983 (the Dairy Act) violates the First Amendment right to free speech and free association. The lawsuit seeks injunctive relief from the mandatory assessment fees paid to NDB on milk produced and marketed in the contiguous United States. These mandatory assessment fees are the primary revenue source for the National Dairy Board (see note 2b).

In 2003, a federal trial court in Pennsylvania found that the Dairy Promotion Program does not violate the claimants' right of free speech and association. However, in February 24, 2004, a three-judge panel of the U.S. Court of Appeals for the Third Circuit reversed this decision and found that the Dairy Promotion Program does violate the claimants' right of free speech and association rights by compelling them to subsidize speech with which they disagree. Currently, no injunction has been issued against the collection of assessments. If this decision is not reversed, however, the Dairy Promotion Program and NDB may be forced to make significant modifications to its current operations or cease operations.

It has been represented to NDB that the USDA intends to vigorously defend against these claims. To that end, on April 9, 2004, the United States Justice Department (on behalf of NDB and the USDA) filed a petition with the Third Circuit requesting that all of the judges of that court reconsider the February 24 decision of the three-judge panel. That petition argues that the panel's decision conflicts with applicable Supreme Court precedents, a key Third Circuit precedent, and with the decisions of two other Circuits (the Ninth and Sixth Circuits) that each upheld the constitutionality of the Dairy Act and rejected the precise argument that the Third Circuit decided to accept. NDB believes that these are very strong arguments in favor of the constitutionality of the Dairy Promotion Program. However, at this time, it is not possible to predict the outcome of the litigation or whether an injunction will be issued against the collection of the assessments.

NATIONAL DAIRY PROMOTION AND RESEARCH BOARD

Schedule of Reconciliation of Operations Budget

Year ended December 31, 2003

	2003 Total expenses	2002 Commitments expensed in 2003	2003 Operations Budget Statement
Organizational group expenses:			
Domestic marketing group	\$ 60,710,527	643,132	60,067,395
Research and evaluation group	4,952,087	—	4,952,087
Communications/member relations group	13,007,120	—	13,007,120
Export group	5,251,770	—	5,251,770
DMI general and administrative	2,632,108	—	2,632,108
General and administrative	436,292	—	436,292
United States Department of Agriculture	554,121	—	554,121
Total organizational group expenses	\$ 87,544,025	643,132	86,900,893

This schedule reconciles the total expenses from the Statement of Activities presented in accordance with accounting principle generally accepted in the United States of America to those reflected in the Operations Budget Statement which is used for management's internal purposes.

The commitments expensed in 2003 represent management's contract commitments established prior to January 1, 2003 which were expensed in the current year.

See accompanying independent auditors' report.



KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Accountants' Report On Applying Agreed-upon Procedures

The Board of Directors
National Dairy Promotion and Research Board:

We have performed the procedures enumerated below, which were agreed to by the U.S. Department of Agriculture (USDA) and National Dairy Promotion and Research Board (NDB), solely to assist the specified parties in evaluating the entities' compliance with The Dairy and Tobacco Adjustment Act of 1983 (Act), the Dairy Promotion and Research Order (Order), and the Agricultural Marketing Services Directive (Directive) entitled *Investments of Public Funds* as of and for the year ended December 31, 2003. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representations regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings were as follows:

- (a) We obtained NDB's budget for the year ended December 31, 2003 and sighted the signature of the Secretary of the USDA.
- (b) We selected four investment purchase transactions during the year ended December 31, 2003, compared them against their respective brokers' advices, and noted the following:
 - The investments purchased were in either U.S. Government Securities or Federal Agency Securities;
 - The investments had maturity periods of one year or less; and
 - The U.S. Government Securities and Federal Agency Securities were held in the name of NDB at the custodial institution.
- (c) We obtained the 1997 investment files and sighted various broker's advices noting that the investment records have been maintained for six years.

We were not engaged to, and did not conduct an examination, the objective of which would be the expression of an opinion on compliance. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the USDA and NDB and is not intended to be and should not be used anyone other than these specified parties.

KPMG LLP

March 26, 2004





KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

March 26, 2004

The Board of Directors
National Dairy Promotion and Research Board
Rosemont, Illinois

Ladies and Gentlemen:

We have audited the financial statements of the National Dairy Promotion and Research Board, for the year ended December 31, 2003, and have issued our report thereon dated March 26, 2004, except for Note 7, as to which the date is April 16, 2004. In planning and performing our audit of the financial statements of the National Dairy Promotion and Research Board, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

This report is intended solely for the information and use of the United States Department of Agriculture, the Board of Directors, management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP



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APPENDIX E-2

SNYDER-COHN-COLLYER-HAMILTON & ASSOCIATES P.C.

Independent Auditor's Report

**To the Board of Directors
National Fluid Milk Processor
Promotion Board
Washington, D.C.**

We have audited the accompanying balance sheet of the National Fluid Milk Processor Promotion Board as of December 31, 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the National Fluid Milk Processor Promotion Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the National Fluid Milk Processor Promotion Board as of December 31, 2003, and the results of its operations, changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 2004 on our consideration of the National Fluid Milk Processor Promotion Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

Snyder, Cohn, Collyer, Hamilton & Associates, P.C.

March 2, 2004
Bethesda, Maryland

Certified Public Accountants and Business Advisors

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National Fluid Milk Processor Promotion Board

Balance Sheet

December 31, 2003

Assets

Current assets:

Cash and cash equivalents	\$ 11,398,626
Assessments receivable, net of allowance for uncollectible accounts of \$64,751	10,970,477
Interest receivable	7,752
Other receivables	<u>373,882</u>

Total assets \$ 22,750,737

Liabilities and net assets

Current liabilities:

Accounts payable	<u>\$ 6,303,801</u>
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Net assets:

Designated for contingencies	1,500,000
Undesignated	<u>14,946,936</u>

Total net assets 16,446,936

Total liabilities and net assets \$ 22,750,737

APPENDIX E

See Accompanying Notes

National Fluid Milk Processor Promotion Board
Statement of Revenues, Expenses and Changes in Net Assets

For the year ended December 31, 2003

Revenues:

Assessments	\$ 105,992,120
California cut-in revenue	132,850
Late payment charges	40,036
Interest income	370,342
Other	<u>8,968</u>

Total revenues	<u>106,544,316</u>
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Expenses:

Program expenses:

Media	72,321,925
Promotions	6,807,355
Public relations	13,350,945
Strategic thinking	1,360,304
Research	1,349,436
Medical advisory panel	208,373
American Heart Association	120,000
Medical research	20,957
Program measurement	<u>148,223</u>

Total program expenses	<u>95,687,518</u>
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Other expenses:

California grant	10,299,826
Administrative	1,966,747
USDA oversight	382,304
USDA compliance audit	<u>48,956</u>

Total other expenses	<u>12,697,833</u>
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Total expenses	<u>108,385,351</u>
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Excess of expenses over revenues	(1,841,035)
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Net assets - beginning	<u>18,287,971</u>
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Net assets - ending	<u>\$ 16,446,936</u>
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See Accompanying Notes

National Fluid Milk Processor Promotion Board

Statement of Cash Flows

For the year ended December 31, 2003

Cash flows from operating activities:

Excess of expenses over revenues	\$ (1,841,035)
Changes in assets and liabilities:	
Decrease in assessments receivable	396,426
Increase in interest receivable	(3,945)
Increase in other receivables	(173,574)
Decrease in accounts payable	<u>(1,340,295)</u>

**Net cash used in operating activities and net decrease
in cash and cash equivalents**

(2,962,423)

Cash and cash equivalents - beginning

14,361,049

Cash and cash equivalents - ending

\$ 11,398,626

APPENDIX E

See Accompanying Notes

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2003

Note 1: Summary of significant accounting policies:

The National Fluid Milk Processor Promotion Board (the Board) was established pursuant to the authority of the Fluid Milk Promotion Act (the Act) of 1990, Subtitle H of the Title XIX of the Food, Agriculture, Conservation and Trade Act of 1990. The purpose of the Board is to administer the provisions of the Fluid Milk Promotion Order (the Order) established pursuant to the Act which establishes an orderly procedure for the development, and the financing through an assessment, of a coordinated program of advertising, promotion, and education for fluid milk products.

The Act requires that a referendum be conducted among processors to determine if a majority favored implementing the fluid milk program. In the October 1993 initial referendum, the majority of processors voted to approve the implementation of the fluid milk program. A continuation referendum was held in February-March 1996. Of the processors voting in that referendum, the majority favored continuation of the fluid milk program. In November 1998, another continuation referendum was held at the request of the Board and processors voted to continue the fluid milk program as established by the Order. The Act and Order state that the United States Department of Agriculture (USDA) will hold future referenda upon the request of the Board, processors representing 10 percent or more of the volume of fluid milk products marketed by those processors voting in the last referendum, or when called by the U.S. Secretary of Agriculture.

For financial reporting purposes, the Board is considered a quasi-governmental agency of the U.S. government. As such, it is exempt from income taxes under the Internal Revenue Code. The USDA and its affiliated agencies operate in an oversight capacity of the Board.

The financial statements of the Board are prepared in conformity with accounting principles generally accepted in the United States of America. To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

Assessments - Beginning August 1, 2002, assessments are generated from those processors marketing more than 3,000,000 pounds of fluid milk per month by a 20-cent per hundred weight assessment on fluid milk products processed and marketed commercially in consumer-type packages in the 48 contiguous United States and the District of Columbia. Prior to August 1, 2002, the minimum monthly assessments were generated from processors marketing more than 500,000 pounds of fluid milk per month. Assessment revenue is recognized in the month in which the fluid milk product is processed.

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2003

Note 1: Summary of significant accounting policies: (continued)

Late payment charges are assessed, as provided under the Act, to processors who do not remit monthly assessments within 30 days following the month of assessment. The late payment charge is equal to .015% of unpaid assessments and accrues monthly. At no time does the Board stop accruing interest on these assessments. The Board's management has established a policy of reserving 50% of the late fee charges.

California grant - In accordance with the Act, the Board is required to provide a grant to a third party equal to 80% of the assessments collected from Regions 14 and 15 to implement a fluid milk promotion campaign. Disbursements under these provisions are recorded as "California Grant" in the accompanying financial statements.

Cash equivalents - For purposes of the statement of cash flows, the Board considers investments with an original maturity of three months or less to be cash equivalents.

Use of estimates - The Board has made certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Advertising - In accordance with its mission, the Board has approved the development of direct and nondirect response advertising and promotional activities. All costs related to these activities are charged to expense as incurred.

Note 2: Cash and cash equivalents:

At December 31, 2003, the bank balance of the Board's cash deposits was entirely covered by federal depository insurance or was covered by collateral held by the Board's agent in the Board's name.

	<u>Carrying Value</u>
Cash deposits	\$ 2,226,779
Repurchase agreements	1,636,677
Investments	<u>7,535,170</u>
	<u>\$11,398,626</u>

At December 31, 2003, the repurchase agreements were secured as to principal plus accrued interest by U.S. government securities held in the respective banks' safekeeping account, in the Board's name, with the Federal Reserve Bank.

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2003

Note 2: Cash and cash equivalents: (continued)

The Board is required to follow the Agricultural Marketing Service (AMS) investment policy. Accordingly, the Board is authorized to invest in securities consisting of obligations issued or fully insured or guaranteed by the U.S. or any U.S. government agency, including obligations of government-sponsored corporations, and must mature within one year or less from the date of purchase. At December 31, 2003, investments consist entirely of U.S. government agency obligations. Investments are carried at cost, which approximates fair value. The Board's investments are held by the counterparty's trust department or agent in the Board's name.

At December 31, 2003, investments consisted of the following:

	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Carrying Amount</u>
U.S. Securities:				
FHLMC discount note	10/31/03	01/08/04	1.06%	\$ 999,964
FHLMC discount note	11/07/03	01/29/04	1.07	2,507,798
FHLB discount note	12/04/03	02/25/04	1.06	500,773
FHLMC discount note	12/10/03	02/26/04	1.05	1,022,668
FNMA discount note	12/19/03	03/24/04	1.05	<u>2,503,967</u>
				<u>\$7,535,170</u>

At December 31, 2003, the Board was owed accrued interest of \$7,752.

Included in cash and cash equivalents is \$1,500,000 of Board designated cash reserves.

Note 3: Compliance matters:

In accordance with the Act and the Order, effective one year after the date of the establishment of the Board, the Board shall not spend in excess of 5% of the assessments collected for the administration of the Board. For the year ended December 31, 2003, the Board did not exceed this limitation.

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2003

Note 4: Program administration:

The Board entered into an agreement with the International Dairy Foods Association (IDFA) to administer the fluid milk program. Under this agreement, IDFA engages outside organizations to develop programs for advertising, promotion, consumer education, and certain minority initiatives. The organizations are:

- Draft (began January 2004)
- Bozell Worldwide, Inc./Lowe & Partners Worldwide
- Flair Communication, Inc. (ended January 2004)
- Weber Shandwick Worldwide
- Siboney USA

In 2003, Lowe & Partners Worldwide succeeded Bozell Worldwide, Inc. as a result of their merger.

Under this and related agreements, IDFA also directly provides program management, administrative support and employee benefits management services and leases office space to the Board. During the year ended December 31, 2003, the Board incurred approximately \$2,021,000 for directly provided services. At December 31, 2003, the Board owed IDFA \$484,080 for costs billed under these agreements.

Note 5: Commitments:

The Board entered into an agreement during fiscal year 2000 with Walt Disney World Hospitality & Recreation Corporation (WDWHRC), whereby the Board will pay WDWHRC \$1,800,000 each year for the next six years through 2006 in exchange for the sponsorship and certain promotional rights at the Sports Complex in order to cooperatively develop programs to promote fluid milk products at Walt Disney World Resort. In December 2003, both parties agreed to extend the term of the agreement for another three years through 2009 at the previously agreed rate of \$1,800,000 to be increased annually by the change in the Consumer Price Index.

In 2002, the Board entered into a five-year agreement with the American Heart Association. Under the agreement, the Board pays the American Heart Association \$120,000 annually from 2002 to 2007 for use of the logo on the processors' milk containers.

National Fluid Milk Processor Promotion Board

Notes to Financial Statements

December 31, 2003

Note 6: Operating lease:

The Board incurred \$118,800 of rental expense during 2003, under a sublease with an automatic renewal option. For 2004, the annual lease payment under the contract will be \$124,800.

Note 7: Transactions with the United States Department of Agriculture:

Under the provisions of the Act and the Order, the Board is required to pay the United States Department of Agriculture certain fees for oversight and evaluation costs. These costs were \$431,260 during 2003.

Note 8: Related party activity:

Accounting services for the Board are performed by Rubin, Kasnett & Associates, P.C. (RK&A); the cost of these services was \$264,362 during 2003. A principal of RK&A serves as the Chief Financial Officer of the Board and receives compensation for services performed.

The Board has entered into an employment agreement with its Chief Executive Officer (CEO). The agreement runs from January 1, 2004 to December 31, 2006 and provides for annual compensation, benefits and increases based upon the CEO's annual performance evaluation. The agreement also includes provisions that would require severance payments on early termination of the agreement.

NATIONAL FLUID MILK PROCESSOR PROMOTION BOARD AUDIT
SUPPLEMENTARY INFORMATION: PART I



SNYDER·COHN·COLLYER·HAMILTON & ASSOCIATES P.C.

Independent Auditor's Report on Supplementary Information

**To the Board of Directors
National Fluid Milk Processor
Promotion Board
Washington, D.C.**

Our report on our audit of the basic financial statements of the National Fluid Milk Processor Promotion Board for 2003 appears on page 1. We conducted our audit for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information presented on pages 12 to 15 for the year ended December 31, 2003 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Snyder, Cohn, Collyer, Hamilton & Associates, P.C.

March 2, 2004
Bethesda, Maryland

Certified Public Accountants and Business Advisors

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National Fluid Milk Processor Promotion Board

Schedule of Revenues and Expenses Actual Compared to Budget (Budget Basis)

For the year ended December 31, 2003

	Unexpended/ Amended Budget	Current Year Actual	Actual Over (Under) Budget
Revenues:			
Assessments	\$ 105,800,000	\$ 105,992,120	\$ 192,120
California cut-in revenue	-	132,850	132,850
Late payment charges	-	40,036	40,036
Interest income	-	370,342	370,342
Other	-	8,968	8,968
Carryover - prior years	<u>5,249,500</u>	<u>-</u>	<u>(5,249,500)</u>
Total revenues	<u>111,049,500</u>	<u>106,544,316</u>	<u>(4,505,184)</u>
Expenses:			
Program expenses:			
Program - current year	98,500,800	93,639,096	(4,861,704)
Program - prior years	<u>6,164,045</u>	<u>2,048,422</u>	<u>(4,115,623)</u>
Total program expenses	<u>104,664,845</u>	<u>95,687,518</u>	<u>(8,977,327)</u>
Other expenses:			
California grant	9,991,000	10,299,826	308,826
Administrative	2,117,700	1,966,747	(150,953)
USDA oversight	<u>440,000</u>	<u>431,260</u>	<u>(8,740)</u>
Total other expenses	<u>12,548,700</u>	<u>12,697,833</u>	<u>149,133</u>
Less encumbrances - prior years	<u>(6,164,045)</u>	<u>-</u>	<u>6,164,045</u>
Total expenses	<u>111,049,500</u>	<u>108,385,351</u>	<u>(2,664,149)</u>
Excess of expenses over revenues	<u>\$ -</u>	<u>\$ (1,841,035)</u>	<u>\$ (1,841,035)</u>

National Fluid Milk Processor Promotion Board

Schedule of Program Expenses Actual Compared to Budget (Budget Basis)

For the year ended December 31, 2003

	Current Year Amended Budget	Expended Current Year Actual	Actual Over (Under) Budget	Prior Year Unexpended Budget	Expended Prior Year Actual	Actual Over (Under) Budget	Total Program Activity
Expenses - 2003 budget							
Media	\$ 72,272,000	\$ 71,712,635	\$ (559,365)	\$ 1,308,661	\$ 609,290	\$ (699,371)	\$ 72,321,925
112 Promotions	8,229,000	6,588,885	(1,640,115)	1,917,314	218,470	(1,698,844)	6,807,355
Public relations	13,819,000	13,258,798	(560,202)	318,184	92,147	(226,037)	13,350,945
Strategic thinking	1,686,000	1,010,828	(675,172)	646,295	349,476	(296,819)	1,360,304
Research	1,930,000	824,300	(1,105,700)	1,047,485	525,136	(522,349)	1,349,436
Medical advisory panel	340,000	203,593	(136,407)	126,418	4,780	(121,638)	208,373
American Heart Association	-	-	-	480,000	120,000	(360,000)	120,000
Medical research	62,500	3,427	(59,073)	153,120	17,530	(135,590)	20,957
Program measurement	162,300	36,630	(125,670)	166,568	111,593	(54,975)	148,223
Total program expenses	\$ 98,500,800	\$ 93,639,096	\$ (4,861,704)	\$ 6,164,045	\$ 2,048,422	\$ (4,115,623)	\$ 95,687,518

National Fluid Milk Processor Promotion Board

Schedule of Administrative Expenses Actual Compared to Budget (Budget Basis)

For the year ended December 31, 2003

	Current Year Amended Budget	Current Year Actual	Actual Over (Under) Budget
Management contract	\$ 327,700	\$ 310,951	\$ (16,749)
Board meeting expenses	350,000	291,674	(58,326)
Staff salaries and benefits:			
Staff salaries and compensation	391,388	396,679	5,291
Staff retirement benefit	39,138	46,733	7,595
Payroll taxes	13,650	14,259	609
Health insurance	8,000	6,160	(1,840)
Life insurance	1,300	1,433	133
Disability insurance	1,400	991	(409)
Workers compensation	675	843	168
Other employee benefits	2,160	1,620	(540)
Total staff salaries and benefits	<u>457,711</u>	<u>468,718</u>	<u>11,007</u>
Finance and administration:			
Contract staff	140,000	139,830	(170)
Financial services	265,000	264,362	(638)
Total finance and administration	<u>405,000</u>	<u>404,192</u>	<u>(808)</u>
Other operating expenses:			
Legal	200,000	154,163	(45,837)
Audits	50,000	63,874	13,874
Office facilities	100,800	100,800	-
Support and maintenance	18,000	18,000	-
Staff travel	105,000	91,605	(13,395)
Telephone	5,000	1,345	(3,655)
Insurance	32,500	44,301	11,801
Postage and delivery	20,000	15,149	(4,851)
Unallocated administrative expense	45,989	1,975	(44,014)
Total other operating expenses	<u>577,289</u>	<u>491,212</u>	<u>(86,077)</u>
Total administrative expenses	<u>\$ 2,117,700</u>	<u>\$ 1,966,747</u>	<u>\$ (150,953)</u>

National Fluid Milk Processor Promotion Board

Schedule of Cash Receipts and Disbursements

For the year ended December 31, 2003

Cash receipts from operations:

Assessments	\$ 106,214,972
California cut-in revenue	132,850
Late payment charges	40,036
Interest income	366,397
Other	<u>8,968</u>

Total revenues	106,763,223
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Cash disbursements for operations	<u>(109,725,646)</u>
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Excess of disbursements over operating receipts	(2,962,423)
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Cash and cash equivalents - beginning	<u>14,361,049</u>
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Cash and cash equivalents - ending	<u>\$ 11,398,626</u>
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NATIONAL FLUID MILK PROCESSOR PROMOTION BOARD AUDIT

SUPPLEMENTARY INFORMATION: PART II



SNYDER-COHN-COLLYER-HAMILTON & ASSOCIATES P.C.

Independent Auditor's Report on Compliance and on Internal
Control Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance with
Government Auditing Standards

**To the Board of Directors
National Fluid Milk Processor
Promotion Board
Washington, D.C.**

We have audited the financial statements of the National Fluid Milk Processor Promotion Board as of and for the year ended December 31, 2003, and have issued our report thereon dated March 2, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the National Fluid Milk Processor Promotion Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the National Fluid Milk Processor Promotion Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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To the Board of Directors
National Fluid Milk Processor
Promotion Board

Page two

This report is intended solely for the information and use of the National Fluid Milk Processor Promotion Board, management of the National Fluid Milk Processor Promotion Board, and the Dairy Programs, Promotion and Research Branch of the Agricultural Marketing Service Agency of the United States Department of Agriculture and is not intended to be and should not be used by anyone other than these specified parties.

Snyder, Cohn, Collyer, Hamilton & Associates, P.C.

March 2, 2004
Bethesda, Maryland

NATIONAL FLUID MILK PROCESSOR PROMOTION BOARD AUDIT
SUPPLEMENTARY INFORMATION: PART III



SNYDER·COHN·COLLYER·HAMILTON & ASSOCIATES P.C.

**To the Board of Directors
National Fluid Milk Processor
Promotion Board
Washington, D.C.**

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial statement audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the balance sheet of the National Fluid Milk Processor Promotion Board as of December 31, 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended, and have issued our report thereon dated March 2, 2004. The financial statements were prepared in conformity with accounting principles generally accepted in the United States of America.

In connection with our audit, nothing came to our attention, insofar as it relates to accounting matters, that causes us to believe that the National Fluid Milk Processor Promotion Board:

- Failed to comply with laws and regulations applicable to the National Fluid Milk Processor Promotion Board;
- Failed to comply with Section 1160.212 of the Fluid Milk Promotion Order, relating to the use of assessment funds for the purpose of influencing governmental policy or action;
- Expended assessment funds for purposes other than those authorized by the Fluid Milk Promotion Act and the Fluid Milk Promotion Order;
- Expended or obligated assessment funds on any projects prior to the fiscal year in which those funds were authorized to be expended by the National Fluid Milk Processor Promotion Board's approved Budget and Marketing Plan;
- Did not adhere to the original or amended Budget and Marketing Plan for the year ended December 31, 2003;
- Did not obtain a written contract or agreement with any person or entity providing goods or services to the National Fluid Milk Processor Promotion Board;

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**To the Board of Directors
National Fluid Milk Processor
Promotion Board**

Page two

- Failed to comply with Section 1999H, paragraph (g) of the Fluid Milk Promotion Order, relating to the limitations on the types of investments which may be purchased by the National Fluid Milk Processor Promotion Board and the insurance or collateral that must be obtained for all National Fluid Milk Processor Promotion Board deposits and investments;
- Failed to comply with internal controls;
- Failed to comply with disclosure requirements for lease commitments;
- Failed to comply with standards established requiring signed contracts, USDA approval letters (if necessary), contract term documentation within the file, and CFO's signature on the Board approval letter; or
- Failed to comply with the By-laws of the National Fluid Milk Processor Promotion Board or any other policy of the National Fluid Milk Processor Promotion Board, specifically as they relate to all financial matters, including time and attendance, and travel.

However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the information and use of the National Fluid Milk Processor Promotion Board, management of the National Fluid Milk Processor Promotion Board, and the Dairy Programs, Promotion and Research Branch of the Agricultural Marketing Service Agency of the United States Department of Agriculture and is not intended to be and should not be used by anyone other than these specified parties.

Snyder, Cohn, Collyer, Hammett & Associates, P.C.

March 2, 2004
Bethesda, Maryland